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VENTURE CAPITAL MONITOR

A QUARTERLY UPDATE ON THE CANADIAN VENTURE CAPITAL INDUSTRY

This publication provides current information about the venture capital industry in Canada. The series will track trends in investment activity, report on topical research and look at key technology clusters where investment is taking place.

Introduction

This issue covers venture capital (VC) investment and fundraising activity in Canada during the second quarter of 2012. It also describes recent federal government activity in the VC market.

VC Activity Overview

Investment and fundraising

Investment and fundraising activity increase from Q2 2011 to Q2 2012

Between April and June 2012 136 Canadian companies received $438 million in VC, a 17 percent increase over the $374 million invested over the same period during 2011 (Table 1). This follows a weak first quarter during which $287 million was invested. As a result, $725 million has been invested over the first half of 2012 measuring slightly lower than the $747 million invested over the first two quarters of 2011 (Figure 1).

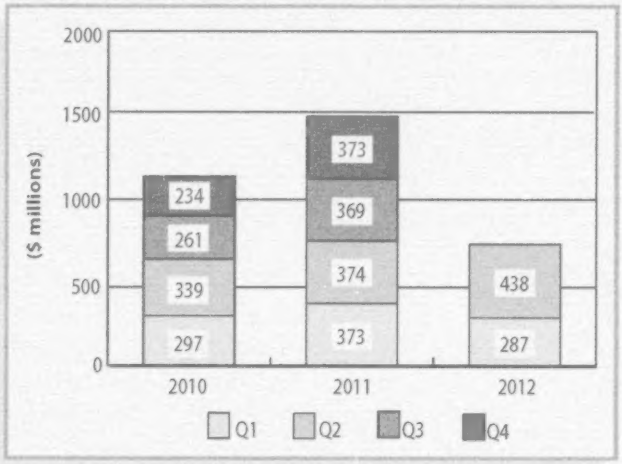
Fundraising activity experienced a second straight quarter of above average performance between April and June. New commitments to domestic funds reached $683 million over Q2 2012; vastly exceeding the $154 million committed to domestic funds during Q2 2011 (Table 1). Through the first half of 2012 fundraising has reached approximately $1.4 billion, already passing the $1.1 billion raised during the entirety of 2011. Notably, $1.1 billion of the total raised has been committed to private independent funds; this is nearly three times the total figure raised by independent funds over 2011 as a whole.

Table 1: VC investment and fundraising, Q2 2011 and Q2 2012

	Q2 2011	Q2 2012	Percent Change
	($ millions)		
Investment	374	438	17
Fundraising	154	683	344

Source: Thomson Reuters Canada 2012.

Figure 1: VC Investment by quarter, 2010 to 2012



Source: Thomson Reuters Canada 2012.

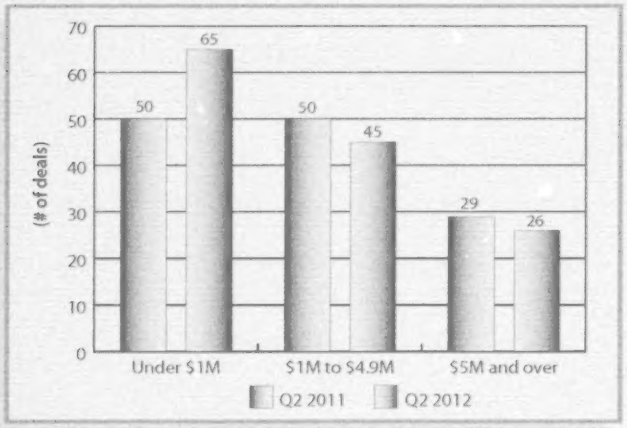
Deal size

Nearly half of all deals completed over Q2 2012 were worth less than $1 million

There were 136 deals completed during Q2 2012, seven more than the 129 deals completed over the same period last year. Deal growth was concentrated in the under $1 million deal range with 65 deals completed, compared to 50 deals over the same period in 2011 (Figure 2). The majority of growth in this range is attributable to new investments in Internet focused information technology (IT) companies. There were 28 new investments in IT completed in this range during Q2 2012 compared to 12 over Q2 2011.

Canadian companies securing deals greater than $1 million declined during Q2 2012 to 71 financings, down from 79 over the same period last year. Notable large deals completed over the quarter include the US$35 million financing of Burnaby's D-Wave Systems Inc., the US$30 million financing of Montréal's Lightspeed Retail Inc. and the US$30 million financing of Toronto's SecureKey Technologies Inc..

Figure 2: Distribution of VC investment by deal size, Q2 2011 and Q2 2012



Source: Thomson Reuters Canada 2012.

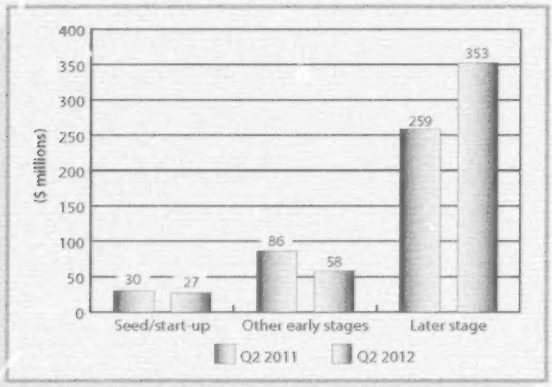
Stage of development

Increase in value of later stage deals balances decline in all other stages

While the number of seed and start-up financings increased during Q2 2012 relative to Q2 2011 (31 compared to 27), the aggregate value of these deals declined from $30 million to $27 million (Figure 3). This trend was more pronounced at other early stages as the total deal value fell from $86 million in Q2 2011 to $58 million in Q2 2012. Declining early stage financing value may be attributed to an absence of early stage life sciences deals as only $5 million was committed to these companies during Q2 2012 compared to $43 million over Q2 2011.

On the other hand, the value of later stage financings climbed significantly with $353 million placed into Canadian companies compared to $259 million during Q2 2011. The increase in later stage financings is the result of a substantial increase in average later stage deal size with deal sizes rising from $3.4 million to $4.7 million on the weight of several very large deals in excess of $30 million. Excluding the top three deals previously mentioned, deal sizes remain $3.4 million for the quarter.

Figure 3: VC investment by stage of development, Q2 2011 and Q2 2012



Source: Thomson Reuters Canada 2012.

New versus follow-on investments

Substantial increase in new investments

The 136 financings completed during Q2 2012 were the most seen since Q4 2008. As well, 74 new deals were recorded over the quarter, the highest figure recorded since Q4 2005, which bodes well for companies receiving first-time VC investments. The new deals were worth a combined value of $176 million, a sizeable increase over the $99.6 million placed into new deals over the same period in 2011.

Year-over-year follow-on deals fell during Q2 2012 from 84 over Q2 2011 to 62 during Q2 2012. This trend is the result of declining follow-on investments at earlier stages by investors as later stage follow-on investments remained unchanged as over the same period in 2011 (Table 2).

Table 2: Number of companies that received new and follow-on investment, Q2 2011 to Q2 2012

Investment		Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012
New	Seed/start-up	12	25	20	21	26
	Other early stages	4	3	4	5	17
	Later stage	29	22	22	18	31
	All	**45**	**50**	**46**	**44**	**74**
Follow-on	Seed/start-up	15	15	15	13	5
	Other early stages	21	13	12	10	9
	Later stage	48	48	56	50	48
	All	**84**	**76**	**83**	**73**	**62**

Source: Thomson Reuters Canada 2012.

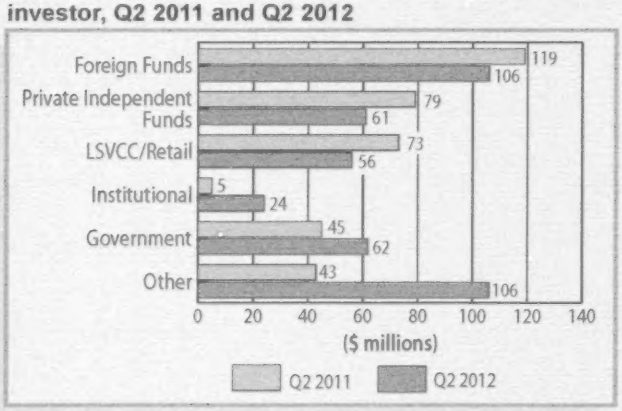
Type of investor

Decline in year-over-year foreign investment matched by increase by other investors

Other investors, such as corporate investors, were highly active throughout the quarter disbursing just over $105 million. Government VCs were also active as their investments grew over Q2 2012 versus Q2 2011 with $62 million placed into 54 companies. Labour-sponsored venture capital funds (LSVCCs) saw a decline in total dollars disbursed, falling from $73 million over Q2 2011 to below $56 million during Q2 2012.

Foreign funds were the most active investors over the quarter having invested $106 million, a small decline from the $119 million invested over the same period the previous year. Consequently, foreign funds accounted for 24 percent of all disbursements in Q2 2012, which is lower than its 33 percent share during the whole of last year (Figure 4).

Figure 4: Distribution of VC investment by type of investor, Q2 2011 and Q2 2012



Source: Thomson Reuters Canada 2012.

Fundraising

Strong fundraising performance by private independent funds during the quarter

As noted earlier, Canadian VC fundraising continued to show particular year-over-year growth in the second quarter of 2012. New commitments to domestic funds reached $683 million over Q2 2012, over four times more than the $154 million committed to funds over Q2 2011. Fundraising over the first half of 2012 has reached approximately $1.4 billion, already having exceeded the $1.1 billion raised during the entirety of 2011. Of the $1.4 billion in new commitments, close to $300 million has been raised by LSVCCs.

Most notably, $1.1 billion of the $1.4 billion raised has been committed to private independent funds; this is nearly three times the total figure raised by independent funds over 2011 as a whole. Leading the way is the: $150 million-first close of TVM Life Science Ventures VII, managed by TVM Capital Life Science; $105 million-first close of Celtic House Venture Partners Fund IV, managed by Celtic House Venture Partners; $100 million-first close of Rho Canada Venture Fund II, managed by Rho Canada; and $50 million-first close of Pangaea Ventures Fund III, LP, managed by Pangaea Ventures. Avrio Ventures also raised more new capital for its Avrio Ventures LLP II, with disclosed commitments to date reaching $64 million. About half of private fundraising has been raised from government and government backed fund of funds such as the Ontario Venture Capital Fund and the Business Development Bank of Canada. The rest has been raised from corporate investors, pension funds and foreign sources.

Regional distribution

Quebec experiences lowest single quarter investment levels on record

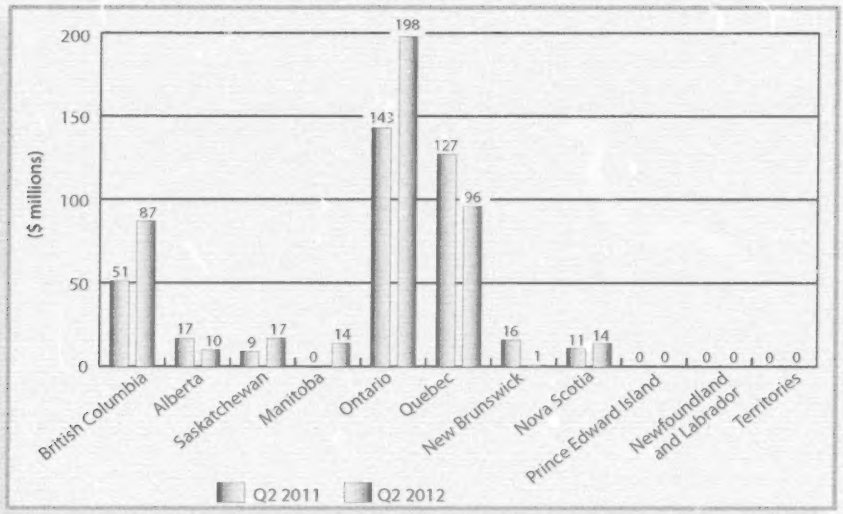
Growth in the Canadian VC market during the second quarter of 2012 was distributed unevenly and was largely concentrated in Ontario and British Columbia (Table 3). Ontario saw disbursements reach $198 million or 38 percent more than the $143 million invested at the same time in 2011. Meanwhile, British Columbia attracted $87 million in VC between April and June resulting in a marked 71 percent increase from the $51 million invested the year before. Consequently Ontario and British Columbia accounted for 45 percent and 20 percent of total VC activity in Q2 2012 respectively.

Table 3: Number of companies receiving VC by province, Q2 2011 and Q2 2012

Province	Q2 2011	Q2 2012	Percent Change
British Columbia	14	17	21
Alberta	6	3	-50
Saskatchewan	5	5	0
Manitoba	0	2	n/a
Ontario	35	46	31
Quebec	64	49	-23
New Brunswick	2	3	50
Nova Scotia	2	10	n/a
Prince Edward Island	0	0	n/a
Newfoundland and Labrador	1	1	n/a
Territories	0	0	n/a

Source: Thomson Reuters Canada 2012.

Figure 5: Regional distribution of VC investment in Canada, Q2 2011 and Q2 2012



Source: Thomson Reuters Canada 2012.

Conversely, Quebec deal-making was below the typical average for a second consecutive quarter. A total of $96 million was invested over Q2 2012, down 25 percent from $127 million invested over the same period last year. As a result, Quebec captured 22 percent of total VC invested in this period, which is at some distance from 2011's one-third share of total VC attracted (Figure 5).

Sector distribution

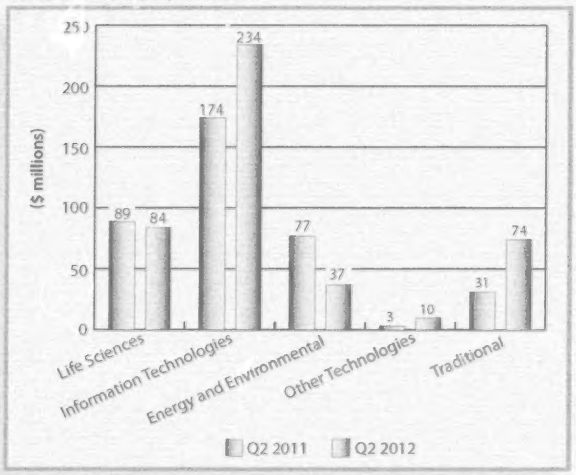
Increase in ICT activity driven by deals into software and Internet-oriented companies

Information and communication technology (ICT) companies paced VC activity over the quarter as 64 ICT companies brought in $234 million, or 53 percent of all Canadian VC. This is an improvement on the $174 million brought in by ICT companies at the same time last year. The bulk of this money was raised by software and Internet-oriented companies, which cumulatively brought in approximately $163 million.

VC activity in the life sciences sectors was relatively steady between April and the end of June, with 22 companies garnering $84 million, slightly down from $89 million the year before. Investment in life science companies was heavily concentrated into later stage companies over the quarter as only $5 million of the total $84 million was invested into earlier stage companies.

For a second quarter in a row, deal-making in clean technology sectors fell, with $37 million going to seven companies or less than half of the $77 million of Q2 2011. In contrast, investment activity in traditional based companies rose sharply over the same period, with $74 million going to 39 companies in the second quarter, or better than double the previous $31 million (Figure 6).

Figure 6: VC investment by industry sector, Q2 2011 and Q2 2012



Source: Thomson Reuters Canada 2012.

Government Activities

Business Development Bank of Canada Activities

During Q2 2012, the Business Development Bank of Canada (BDC) made VC commitments totalling $25.5 million into 25 companies (Table 4). These financings were leveraged to a total of $85 million including contributions by co-investors.

Additionally, the BDC invested a total of $10 million into private independent funds. Funds were matched by co-investors for a total of $43 million.

Table 4: VC activities of the Business Development Bank of Canada, Q2 2012

	BDC	Co-investors	Total	Number of deals
	($ millions)			
Seed/start-up	7.5	11.4	18.9	17
Development	15.7	67.6	83.3	5
Later stage	2.3	6.0	8.3	3
Total	**25.5**	**85.0**	**110.5**	**25**

Source: Business Development Bank of Canada.

Notes

This publication is part of a series prepared by the Small Business Branch. The branch analyses the financial marketplace and how trends in this market impact small businesses' access to financing. Current research is focused on high-growth firms, the aspects of both Canada's VC and general business environment that affect the success of these firms, and the key players in the risk-capital market (for example, VC firms and angels).

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